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May 15, 1998

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re. CC Docket Nos. 96-45, 97-160 -- DA 98-715

Dear Ms. Salas:

Transmitted herewith, on behalf of TDS Telecommunications Corporation (TDS Telecom) are an original and five copies of its comments in response to the Commission's above-referenced request for comments on universal service alternatives.

In the event of any questions concerning this matter, please communicate with this office.

Very truly yours,

Margot Smiley Humphrey

Margot Smiley Humphrey

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MAY 15 1998

Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)	CC Docket No. 96-45
)	
Federal-State Joint Board on)	
Universal Service)	
)	
Forward-Looking Mechanism for)	
High Cost Support for Non-)	CC Docket No. 97-160
Rural LECs)	DA 98-715

COMMENTS OF TDS TELECOMMUNICATIONS CORPORATION

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May 15, 1998

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COMMENTS OF TDS TELECOMMUNICATIONS CORPORATION

TDS TELECOMMUNICATIONS CORPORATION (TDS Telecom or TDS), on behalf of its 106 incumbent local exchange carriers (ILECs) and by its attorneys, submits these comments on alternative proposed plans for providing universal service support to non-rural carriers beginning January 1, 1999.

Summary

TDS Telecom supports the Commission's decision not to adopt a new universal service plan for rural telephone companies in

this proceeding. Because some of the economic and legal conclusions drawn in this non-rural phase will doubtless at least influence future consideration of the issues with respect to rural ILECs, the TDS Telecom rural ILECs must continue to advocate lawful legal and economic interpretations and sound policies in this phase. In particular, TDS Telecom supports rigorous compliance with the statutory mandates, including reasonable parity in the prices, services and access to advanced telecommunications and information offerings available to rural and urban customers, a standard requiring "sufficient," "predictable" and "specific" federal support which no plan or FLEC proxy model proffered so far can satisfy. The statutory standard focuses correctly on customers, and not on imaginary support flows among the states. While this non-rural phase of universal service implementation properly excludes rural ILEC support, TDS Telecom also urges the Commission to decide in the separate, long-pending reconsideration phase that transitional rural ILEC support should not be subject to an indexed cap, that customers in acquired exchanges must not be limited to whatever

support the seller received and that ILECs must be able to disaggregate support to reflect cost differences within their service areas to prevent perverse economic incentives and windfalls for CLECs competing in rural ILEC areas.

TDS Telecom's Interest in the Non-Rural Mechanism

The TDS ILECs, which serve primarily rural areas in 28 states, all qualify as "rural telephone companies" (rural ILECs) under the definition adopted by the Telecommunications Act of 1996 (1996 Act), 47 U.S.C. § 3(37). TDS Telecom ILECs, although not directly the subject of this phase of universal service implementation, find it necessary to comment for at least three reasons: (a) past requirements adopted for larger carriers have often been extended subsequently to small and rural companies, (b) some of the proposals apply or leave open their applicability to rural ILECs¹ and (c) the Commission's interpretation and application of law, economics and policy reached will inevitably guide, if not control, its assumptions and conclusions on such

¹ See, e.g., the Ad Hoc proposal and the two additional alternatives reported by NARUC and the South Dakota commission.

issues in future proceedings involving rural ILECs.²

Section 254 Prescribes the Purposes and Standards Any
Universal Service Proposal Must Satisfy

The Commission's evaluation of alternative universal service proposals must begin and end with the principles and federal responsibilities Congress mandated in the 1996 Act. These require a federal support mechanism that will result in "quality service" at "just, reasonable and affordable rates" and "access to advanced telecommunications and information services in all regions of the nation," §254(b)(1) and (2). The Commission and a joint board must define and "periodically" update an "evolving level" of universal services "that are supported by Federal universal service mechanisms," §254(c). An even more important foundation stone for customers in high cost areas is the national policy mandate in §254(b)(3) that rural and urban customers have

² In an earlier order about the role of the rural task force, for example, the Commission described its focus as "solely on studying the establishment of a forward looking economic cost (FLEC) mechanism for rural carriers" and "[s]pecifically...whether a FLEC mechanism for rural carriers should have different platform design features or input values than the mechanism adopted for non-rural carriers." Public Notice FCC J-1, CC Docket No. 96-45 (rel. September 17, 1997).

access to "reasonably comparable" rates, services and "advanced telecommunications and information services." ³

The statute also requires a federal support mechanism that is "predictable"⁴ and "sufficient" to "achieve the purposes of this section [§254]."⁵ A state may have its own more rigorous definition of universal service, but must support any such supplemental state mandates by a separate "specific" and "sufficient" stand-alone state mechanism, which must not burden the federal support mechanism (§254(f)).

³ Section 254(b)(3) provides:

Access in rural and high cost areas.--Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

⁴ Federal and state mechanisms alike are required to be "specific" and "sufficient" by §254(b)(5).

⁵ Subsection 254(e), dealing with the federal support mechanism, provides for receipt by eligible telecommunication carriers of "specific Federal universal service support" that "should be explicit and sufficient to achieve the purposes of this section."

These provisions establish the raison d'etre and fundamental standard for evaluating any plan to implement the national universal service commitment to customers in high cost rural areas. The national universal service program is designed to spread enough of the higher costs of providing service in less densely populated or more remote locations across the nationwide customer base of all interstate providers. Sharing the high costs broadly will correct for marketplace forces that would otherwise relegate rural customers to paying higher rates for a network and services that will increasingly fall short of urban telecommunications and information resources. Through a nationwide cost recovery mechanism, rural customers will be able to participate, on terms closely equivalent to their urban counterparts, in the same opportunities offered by the emerging telecommunications- and information-rich society, economy and culture. Any alternative proposal adopted here (or later applied to rural ILECs and their customers) must live up to these express national statutory commitments, including the results Congress specified -- reasonable rural and urban parity in rates, services

and access to advanced services -- and a federal support mechanism that provides specific, predictable and, above all for high cost areas, sufficient federal support.

No Current Proposal Can Be Shown to Satisfy the Statutory Mandates and Standards

Most of the proposals assume the application of a forward looking economic cost (FLEC) proxy model that has yet to be completed or adopted. Hence, even apart from the errors of fact⁶ and law⁷ that invalidate the Commission's "place holder" 25% federal share decision, there is simply no basis for determining whether rates, services and infrastructure development in rural Alabama, for example, will be "reasonably comparable" to those in

⁶ For example, the Commission's erroneous claim that 25% replicates current interstate cost allocations overlooks all loop support from the pre-Act USF, as well as all DEM Weighting allocations.

⁷ For example, the Commission erroneously claims that the 1996 Act enabled it to order the states to adopt new state universal service mechanisms to recover a share of the high costs identified by the federal universal service definition and support mechanism. This claim ignores the express statutory framework requiring "sufficient" federal support to achieve the Act's purposes, 47 U.S.C. §254(e), and separate, "specific" and optional state support only in the event of a supplemental state universal service definition, §254(f).

the nation's urban markets. And the duty imposed by the statutory prerequisite of "sufficient" federal support demands adequate information for the Commission and Joint Board to reach that conclusion. As the Ad Hoc Working Group candidly admits (p. 51), "[i]n the absence of a decision by the FCC selecting a single model, the results should be considered illustrative rather than definitive." The Telecommunications Industries Analysis Project uses two models, but does not "address or make any judgments on the models."

The reality is that no FLEC proxy model-derived federal support mechanism can be shown to be sufficient, predictable or specific. The models determine the cost of an imaginary new monopoly network that uses the most efficient technology available at the time of each updated determination and, thus, are not "specific" for any high cost universal service provider. To remain forward looking, the models must incorporate all significant efficiency gains in technology or changes in their prospective calculations of network costs over time, and, thus, will not calculate support that is "predictable." The proxy

models also assume that the hypothetical ideally efficient network for which they predict costs will serve all the customers in each geographic unit covered by their cost predictions. This assumption of monopoly provision alone is a fatal defect in any model ostensibly designed to emulate the dynamic cost signals of a competitive market.⁸ In contrast, real world networks will have real world costs that investors will expect to recover if they are to invest in the evolving infrastructure and services that §254 contemplates. The hypothetical costs of tomorrow's phantom state-of-the-art network are not a reasonable measure of what investors evaluate when deciding whether to invest actual dollars in markets that are not at the "start from scratch" stage. While a FLEC-type proxy model may force large companies

⁸ Economist Alfred Kahn has exposed further fundamental economic errors in the concept of a proxy model assumed to ape the dynamic results of the marketplace process in his letter to former Chairman Reed Hundt, dated January 14, 1997. Extension to rural markets would magnify these infirmities: The incentive to invest in network improvements in thin, high cost, low density markets with inherently limited traffic, customer bases and economies of scale are dramatically different if the provider cannot assume, like the model, that its network will serve all customers in the area, let alone retain the few high volume or lowest cost customers.

to remove "implicit support" from allegedly above-cost interstate access rates, it will not, with any predictability, provide sufficient support for rural carriers to maintain adequate investment levels at the prices required for rural-urban comparability.

The Transition Plan The Chairman Proposes to Leave in Place Indefinitely for Rural ILECs Has Worked Well

TDS Telecom agrees with Chairman Kennard that the proverbial advice "if it ain't broke, don't fix it"⁹ applies to the delivery of universal service by rural ILECs to their communities. The federal universal service support through jurisdictional separations that is largely preserved in the interim plan the Commission adopted for rural ILECs in the May 8, 1997 Universal Service Order,¹⁰ keeps in effect (with a few adjustments responding to the 1996 Act) a plan that has enabled companies like those he has visited to provide "first-rate

⁹ Remarks of William Kennard to USTA's Inside Washington Telecom, April 27, 1998.

¹⁰ Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order (rel. May 8, 1997) (Universal Service Order).

telecommunications operation[s]." He now believes that the transition plan does not require changes by 2001 or until "it is right to make changes, and not before." Accordingly, TDS Telecom supports the Commission's determination to exclude rural ILECs from any plan adopted in this phase of implementation for non-rural ILECs. This "look before you leap" approach would be less unpredictable and more specific (with respect to ILECs' costs, albeit not for interim support portable to CLECs) by measurements that at least are derived from using the actual costs of the ILEC's existing network. As the Chairman's first-hand experience of one rural company confirmed, waiting until there is a full blown plan that has been tested and shown to work for rural ILEC areas before risking more changes also preserves a system that has demonstrably provided sufficient federal high cost recovery on a nationwide basis to serve customers well.

In reaching this conclusion, TDS Telecom does not mean to belittle the genuine concern for achieving the statute's mandates in rural ILEC areas demonstrated by other proposals, and particularly by the Ad Hoc Working Group's "hold harmless"

approach.¹¹ Such proposals, like the Chairman's approach that we support, are designed to preserve a system that has been shown to work, at least until another alternative has been shown to achieve the Act's universal service purposes better.

Our concern with the Ad Hoc Working Group's proposal, which covers rural ILECs, and alternatives for discussion described in the NARUC¹² and South Dakota filings, which withhold judgment on whether rural ILECs should be brought under their approach, is with their focus on criteria which we believe are unlawful because they are inconsistent with §254. The principal spurious test these proposals and the TIAP analyses seek to substitute for the lawful statutory standards and principles for federal high cost support discussed above is the notion of evaluating the nationwide federal high cost recovery mechanism on the basis not

¹¹ However, the suggestion that the interim "hold harmless" would be reconsidered in four years and replaced by the lower of embedded or proxy model costs is not as prudent as the US West admission (p.5) that several years of experience with non-rural proxy application should proceed even initial consideration of extending a proxy to rural ILEC areas.

¹² Ex parte submission by James Bradford Ramsey, April 27, 1998, pp. 5,6.

of affordable and comparable rural and urban rates for all customers, but of fictional net gains and losses among the states. Congress enacted the §254 universal service principles and ordered their implementation via a federal support mechanism to spread the benefits – and the high cost burdens – of nationwide telecommunications and information advancements over all users and providers. The statute nowhere refers to any state-to-state balancing, and interjecting parochial state “interests” clashes with the fundamental legal and logical premises of national policy to be effectuated by means of a federal mechanism.¹³

The Commission Should Act on Pending Petitions to Fix and Improve the Rural ILEC Transition

Nor does our support for the Chairman’s wise approach mean that the transition plan is unblemished. The Commission has

¹³ Senator Rockefeller tied the nationwide support mandate to the nationwide benefits of universally available service: “This isn’t a radical concept. As a nation, we share responsibility in many areas... [L]and-locked states like West Virginia, North Dakota and Montana all help pay for the Coast Guard... [T]he same principle applies here. Shared Responsibility.” Cong. Rec. Online via GPO Access, April 3, 1998 (Senate) pp. §3209-§3210 (wais. access. gpo.gov).

before it petitions for reconsideration filed, for example, by the Rural Telephone Coalition (on July 17, 1997) that raise at least three problems with the transition that the Commission should promptly consider and rectify:

(1) Removal of the indexed cap on the total amount of high cost support is necessary to comply with the statute's mandate for sufficient federal support. While TDS Telecom recognizes that the law also requires that support will be necessary and will be used for the proper purpose, 47 U.S.C. §254(e), and that customers nationwide must not be saddled with superfluous support burdens, the Act furnishes no legal authority for an arbitrary cap. One strength of the Ad Hoc proposal is that we understand from its advocates that its provision for regular recalculation of high costs under the existing formulas would replace and eliminate the indexed cap.¹⁴

(2) The Commission should also remove its unlawful restriction freezing the support available for high cost

¹⁴ Another advantage of the Ad Hoc proposal is that it would provide transport support under certain circumstances.

exchanges bought from another carrier at the level of support the seller had been receiving. Prior support for companies serving study areas with large, low cost urban cores was based on the averaged costs of the whole area, and the vast numbers of low cost lines swamped the data for the relatively small number of high cost rural lines. Often, such rural areas have not kept pace with network modernization in the rest of the seller's area or the buyer's rural service area. The sale offers the customers the opportunity for modernization that Congress intends for all customers in rural and urban areas alike. Freezing the high cost support to what the seller received will either deny the customers the benefit of ownership by a carrier focused squarely on high quality rural service or deter the buyer from upgrading and extending to those customers the telecommunications and information access opportunities they deserve. Section 254(e) requires sufficient support to achieve the Act's universal service purposes, not sufficient support for all customers except for customers whose exchanges are sold.

(3) The Commission should permit disaggregation of

transitional support by rural ILECs faced with competition. The transitional support portability rule gives a CLEC that wins a rural ILEC customer the per line support based on the ILEC's average high cost throughout its entire study area. However, the ILEC's costs typically vary widely from the densest to the least-populated locations it serves. A CLEC will have a strong but uneconomic incentive to provide its own lower cost service to the lowest cost, densest core of the ILEC's area, and to resell the ILEC's subsidized service for the high cost outlying customer locations. In this way, the CLEC can game the system to secure a windfall. It will receive support for the low cost service it provides at an average cost that exceeds the costs it (or the ILEC) incurs to serve those customers. It also secures the benefit of the support included in the high cost areas it serves by resale. The nationwide customer base thus must pay more than the universal service costs and the ILEC is unable to compete fairly to retain the low cost lines it must serve at above cost average prices.

Conclusion

For the reasons outlined above, TDS Telecom urges the Commission to adhere to the decision not to include rural ILECs in any plan this phase produces, but to adhere rigorously to the statutory mandates and intent of Congress in its consideration and conclusions here. The alternatives before the Commission in this phase do not comply with the statutory universal service requirements. While endorsing the decision to exclude rural ILEC universal service mechanisms here, TDS also respectfully urges the Commission to grant pending reconsideration requests in its underlying implementation proceeding to remedy some important shortcomings of the rural ILEC transition.

Respectfully submitted,

TDS TELECOMMUNICATIONS CORPORATION

By: /s/ Margot Smiley Humphrey
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May 15, 1998

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TDS Telecom Comments

CC Docket Nos. 96-45,
97-160 -- DA 98-715

CERTIFICATE OF SERVICE

I, Victoria C. Kim, a secretary in the offices of Koteen & Naftalin, hereby certify that true copies of the foregoing Comments of TDS Telecommunications Corporation, Inc. have been served on the parties of the attached service list, via first class mail, postage prepaid on the 15th day of May, 1998.

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